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Direct Material Procurement.(Industry Trend or Event)

Electronic News, April 2, 2001, by Edwin C. Winder

Communication--It is the cornerstone of business success today. And nowhere is that more apparent than on the Internet. Consider the almost overnight acceptance of e-mail. Now e-mail is the standard in business communication. And it's no wonder why: The ability of a business to receive and respond to information quickly saves time and improves efficiency.

No sooner had e-mail become a part of our lives than e-commerce and the exchange of business-to-business (B2B) goods over the Internet began to flourish. Electronic procurement platforms, such as Ariba and Commerce One, embarked on transforming maintenance, repair and operation (MRO) procurement, by helping to streamline MRO ordering via the Internet. The result: Companies have begun to realize savings in time and money, because buying a box of pens no longer requires triplicate forms and three signatures. Now all it takes is a few mouse clicks.

But to a member of the high-tech supply chain, how important are office supplies and plant maintenance items to the overall financial performance of the company? The answer is: Not very important at all. San Jose-based Gartner Group estimates that only 15 percent of expenditures of manufacturing companies goes toward MRO. The bulk of the expenditures, the remaining 85 percent, goes toward what is known as direct materials--the raw materials, components, and subassemblies that create the finished goods. The cost of these items determines the cost of goods sold, a critical metric for manufacturing companies.

Not only does direct material represent the bulk of expenditures, it affects the top line as well. While not having MRO items on hand may present an inconvenience, the company can still maintain its production levels. But when there is a shortage of direct materials, production lines stop, factories go dark, and the employees go home. Such instances spell D-A-N-G-E-R to a company's top-line revenues and bottom-line profits. In short, MRO materials support the business operations of a manufacturing company; direct materials are the business operation.

While direct material procurement processes lie clearly at the core of a manufacturing business, enabling companies to buy materials over the Internet has taken a back seat to MRO e-procurement. The reason: Direct material procurement processes are substantially more

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complex than those of MRO.

Direct materials are exchanged between component OEMs, distributors, contract manufacturers and system OEMs through an intricate, multilevel supply chain in which buyers can also be suppliers and competitors can also be partners. These trading partners exchange large volumes of information-information on component cost and availability, inventory levels, production status and shipping schedules--all of which become out-of-date the moment they are published.

The Internet provides a path for delivering tremendous value to those companies which take the lead in implementing solutions for direct material procurement. But caution should be taken when choosing a direct material procurement solution provider. The technology behind these solutions is very complex, going well beyond that of traditional Web sites. Furthermore, there are non-technological considerations that can make or break an implementation. The solution must be easy to use, it must provide benefits to all members of the supply chain and it must preserve the personal relationships that make the supply chain work.

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